EXECUTIVE SUMMARY

PURPOSE OF THE REPORT

The North American Free Trade Agreement (NAFTA) entered into force on January 1, 1994. In accordance with Section 512 of the NAFTA Implementation Act, this Study provides a comprehensive assessment of the operation and effects of the NAFTA, including the economic effects in aggregate and in selected manufacturing sectors and agriculture, and the implementation of the NAFTA environmental and labor agreements. This Study reviews the findings from a variety of outside studies and analyzes Mexican and U.S. data, attempting wherever possible to isolate the effects of the NAFTA from other factors, as stipulated in the statute.

TRADE IN NORTH AMERICA

U.S. trade with Canada and Mexico is much larger relative to the size of these economies than with any other trading partners, in large part reflecting shared land borders and geographical proximity.

- In 1996, nearly one-third of U.S. two-way trade in goods with the world was with Canada and Mexico ($421 billion). Two-way trade with our NAFTA partners has grown 44 percent since the NAFTA was signed, compared with 33 percent for the rest of the world. Mexico and Canada accounted for 53 percent of the growth in total U.S. exports in the first four months of 1997.

- Canada was in 1993 -- and remains today -- our largest trading partner, accounting for $290 billion in two-way trade in 1996. Between 1993 and 1996, U.S. goods exports to Canada were up by 33.6 percent to $134.2 billion.

- U.S. exports to Mexico grew by 36.5 percent (or $15.2 billion) from 1993 to a record high in 1996, despite a 3.3 percent contraction in Mexican domestic demand over the same period.

- Exports to Canada and Mexico supported an estimated 2.3 million jobs in 1996; this represents an increase of 311,000 jobs since 1993, 189,000 supported by exports to Canada and 122,000 by exports to Mexico.

- Exports to Mexico were up by 54.5 percent in the first four months of 1997 relative to the same period in 1993. In the first four months of 1997, U.S. exports to Mexico virtually equalled U.S. exports to Japan, our second largest market -- even though Mexico's economy is one twelfth the size of Japan's.

NAFTA'S EFFECT ON TRADE BARRIERS

Under NAFTA, Mexico has reduced its trade barriers on U.S. exports significantly and dismantled a variety of protectionist rules and regulations, while the United States -- which started with much lower tariffs -- has made only slight reductions.

- Before NAFTA was signed, Mexican applied tariffs on U.S. goods averaged 10 percent. U.S. tariffs on Mexican imports averaged 2.07 percent, and over half of Mexican imports entered the United States duty-free. (Figure 1.)

- Since NAFTA was signed, Mexico has reduced its average applied tariffs on U.S. imports by 7.1 percentage points, compared with a reduction of 1.4 percentage points in the United States. The United States would have made some of these tariff reductions under the Uruguay Round even in the absence of NAFTA.

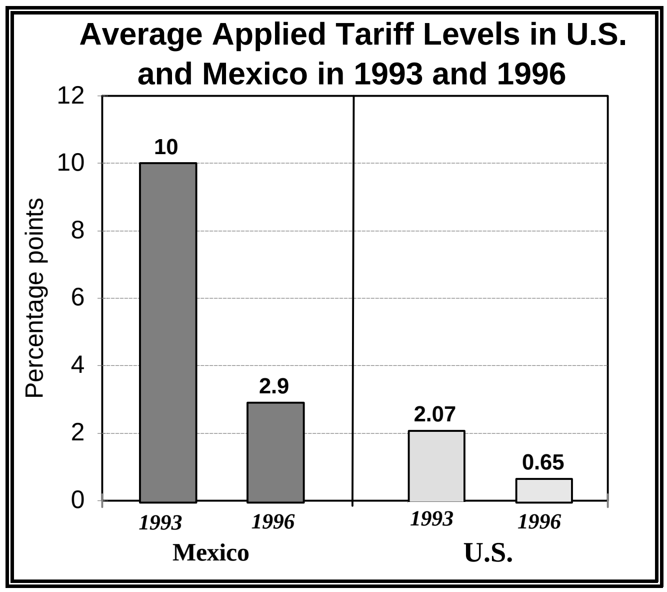

Figure 1

NAFTA'S EFFECTS ON THE U.S. ECONOMY

Several studies conclude that NAFTA contributed to America's economic expansion. NAFTA had a modest positive effect on U.S. net exports, income, investment and jobs supported by exports.

- It is challenging to isolate NAFTA's effects on the U.S. economy, since NAFTA has only been in effect for three years, and events such as the severe recession in Mexico, the depreciation of the Mexican peso, and U.S. tariff reductions under the Uruguay Round have taken place during the same period.

- Nonetheless, several outside studies conclude that NAFTA has resulted in a modest increase in U.S. net exports, controlling for other factors. A new study by DRI estimates that NAFTA boosted real exports to Mexico by $12 billion in 1996, compared to a smaller real increase in imports of $5 billion, controlling for Mexico's financial crisis. An earlier study by the Dallas Federal Reserve finds that NAFTA raised exports by roughly $7 billion and imports by roughly $4 billion. The relatively greater effect on exports partly reflects the fact that under NAFTA Mexico reduced its tariffs roughly 5 times more than the United States.

- DRI estimates that NAFTA contributed $13 billion to U.S. real income and $5 billion to business investment in 1996, controlling for Mexico's financial crisis.

- These estimates suggest that NAFTA has boosted jobs associated with exports to Mexico between roughly 90,000 and 160,000. The Department of Commerce estimates that the jobs supported by exports generally pay 13 to 16 percent more than the national average for non-supervisory production positions.

NAFTA'S EFFECTS ON THE MEXICAN ECONOMY

In 1995, Mexico experienced its most severe economic recession since the 1930s. Comparing Mexico's recovery in 1996 with Mexico's recovery from its last financial crisis in 1982, when NAFTA was not in effect, reveals that both the Mexican economy and American exports recovered more rapidly following the 1995 crisis than the 1982 crisis, in part because of the economic reforms locked in by NAFTA. Mexico's strong economic adjustment program and bilateral and multilateral financial support were also important.

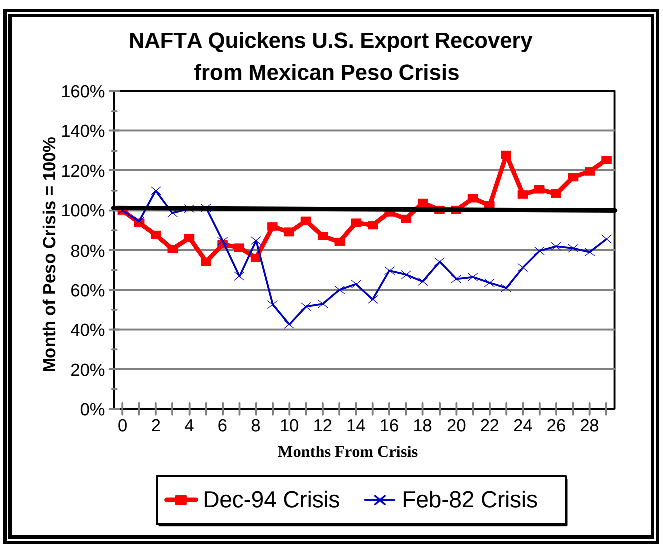

Figure 2

- Following Mexico's 1982 financial crisis, Mexican output drifted down for nearly two years before rising again and did not recover to pre-crisis levels for five years. Although Mexican economic output dropped more quickly in 1995, it also rebounded more quickly, reaching pre-crisis peaks by the end of 1996. Similarly, following the 1982 crisis, it took Mexico 7 years to return to international capital markets, while in 1995, it took 7 months.

- Following Mexico's 1982 financial crisis, Mexico raised tariffs by 100 percent, and

American exports to Mexico fell by half and did not recover for seven years. (Figure 2.) In 1995, Mexico continued to implement its NAFTA obligations even as it raised tariffs on imports from other countries. As a result, American exports recovered in 18 months and were up nearly 37 percent by the end of 1996 relative to pre-NAFTA levels, even though Mexican consumption was down 3.3 percent.

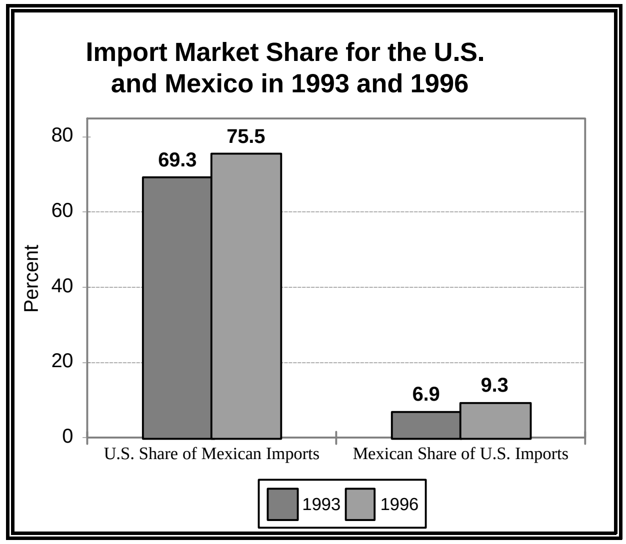

Figure 3

NAFTA'S EFFECTS IN KEY SECTORS

U.S. suppliers hold dominant shares of Mexico's import markets and in many sectors have expanded their shares significantly under NAFTA, at the expense of suppliers from other countries. In almost all sectors, Mexico has made large reductions in tariff barriers under NAFTA, compared with only slight U.S. reductions.

- Increases in the U.S. share of Mexico's import market are indicative of NAFTA's effects, since they control for factors that affect all foreign suppliers similarly, such as Mexico's recession. Since NAFTA went into effect, U.S. suppliers have seen their share of Mexico's import market grow from 69.3 percent to 75.5 percent, reflecting a 10 percentage point average tariff advantage over foreign suppliers. Mexico's share of American imports has risen from 6.9 percent to 9.3 percent. (Figure 3.)

- Reductions in Mexican barriers in key sectors have led to U.S. share gains in Mexican import markets. Since NAFTA was signed, the U.S. share of Mexican imports is up 17.2 percentage points to 86.4 percent in the textiles sector, where Mexico has cut tariffs by 10.7 percentage points under NAFTA. The U.S. share is up 19.2 percentage points to 83.1 percent in the transport equipment sector, where Mexico has cut tariffs 10.2 percentage points

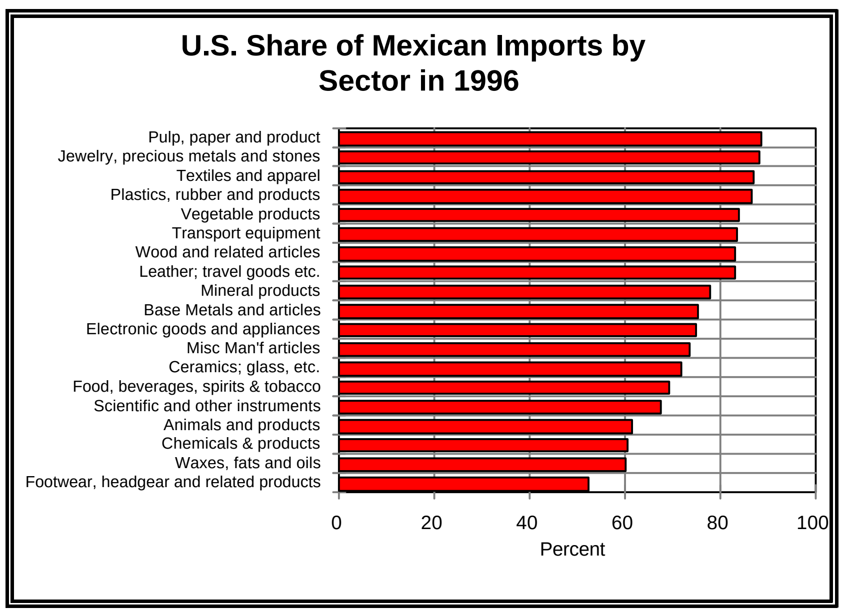

Figure 4

under NAFTA. And the U.S. share is up 5.7 percentage points to 74.3 percent in the electronic goods and appliances sector, where Mexico has cut tariffs by 9.0 percentage points under NAFTA.

- Under NAFTA, Mexican tariff reductions of 9.0 percentage points on electronic goods and appliances are more than 4 times greater than U.S. reductions; Mexican tariff reductions on transport equipment of 10.2 percentage points are more than 9 times greater than U.S. reductions;

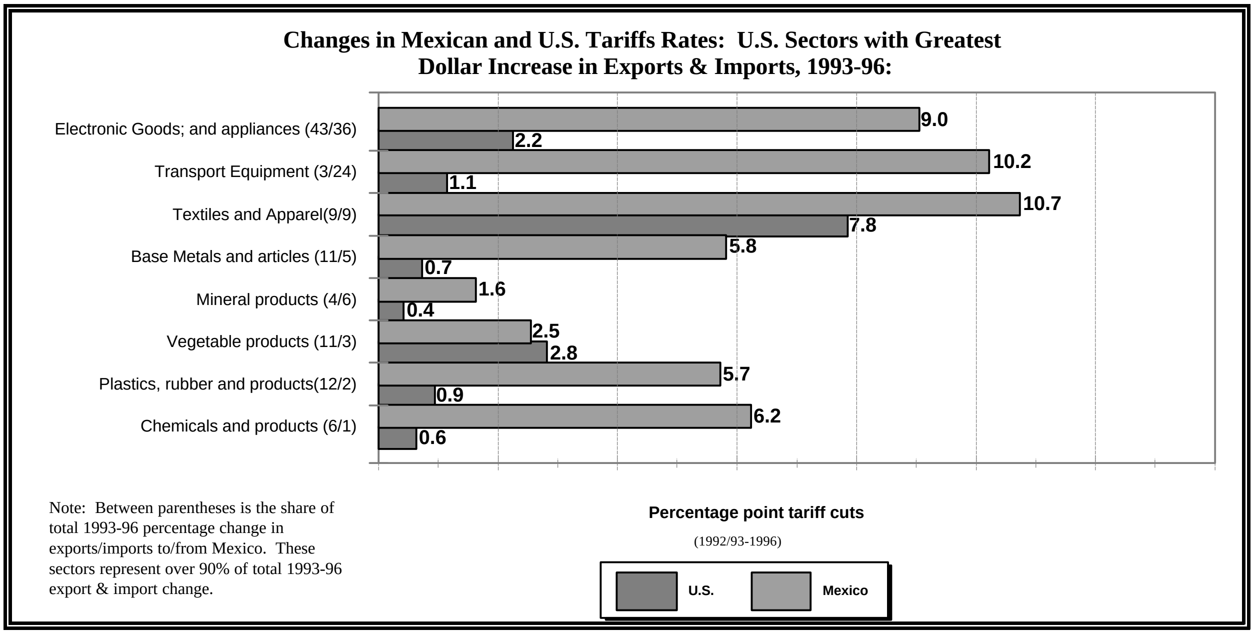

Figure 5

and Mexican tariff reductions of 6.2 percentage points in the chemicals industry are more than 10 times greater than U.S. reductions. (Figure 5.)

- Since NAFTA was signed, U.S. exports to Mexico have made significant gains in several sectors, despite the severe Mexican recession. However, analysis by the International Trade Commission (ITC) shows that data inadequacies at the sectoral level make it difficult to isolate the effects of NAFTA on absolute trade flows.

- In industries such as autos, chemicals, textiles and electronics, NAFTA is permitting American companies to achieve synergies across the North American market, improving their strategic positions abroad and contributing to strong growth in employment, production, and investment at home.

- In several industries that have experienced strong import growth from Mexico, Mexican imports have largely displaced imports from other regions, which have lower U.S. domestic content. In the apparel industry, the share of U.S. imports supplied by Mexico rose from 4.4 percent in 1993 to 9.6 percent in 1996, while the share of U.S. imports from China, Hong Kong, Taiwan and Korea fell from 39 percent in 1993 to 30 percent in 1996. (Figure 6.) Close to 2/3 of the value of Mexican apparel imports in 1996 was comprised of U.S. content.

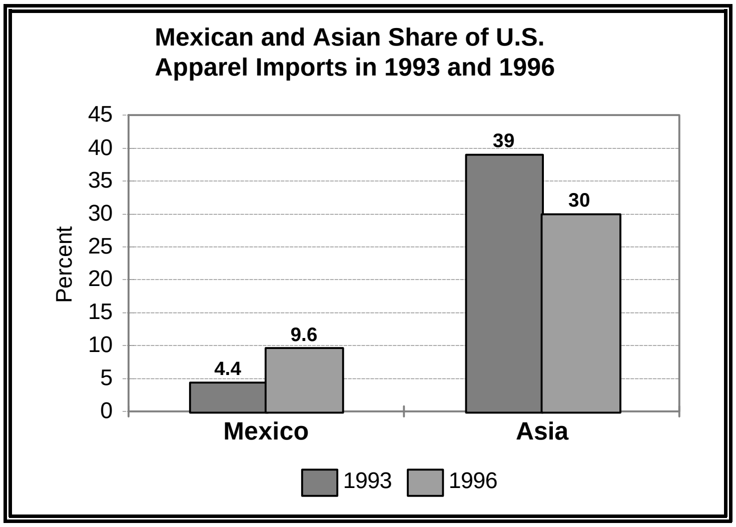

Figure 6

LABOR PROTECTION

The North American Agreement on Labor Cooperation (NAALC) established by the NAFTA has, for the first time, created North American cooperation on fundamental labor issues and has enhanced oversight and enforcement of labor laws.

- The NAALC submission process subjects member governments to public and international attention for alleged violations of labor laws. The submission process has resulted in such outcomes as recognition of a union previously denied recognition and permitting secret union ballots at two companies where union votes previously were not secret.

- Between 1993 and 1996, Mexico's Secretariat of Labor and Social Welfare increased funding for enforcement of labor laws by almost 250 percent.

- Mexico reports a 30 percent reduction in the number of workplace injuries and illnesses since the NAFTA was signed.

- Under the NAALC, the Canadian, Mexican, and U.S. governments have initiated cooperative efforts on a variety of labor issues, including occupational safety and health, employment and training, industrial relations, worker rights and child labor and gender issues.

EXECUTIVE SUMMARY

ENVIRONMENTAL PROTECTION

NAFTA includes mechanisms to address environmental problems that have long challenged communities along the 2000-mile shared border with Mexico. NAFTA's environmental agreements are also encouraging regional cooperation on broader environmental issues and improved enforcement of Mexican environmental laws.

- Environmental institutions established under NAFTA are certifying and financing infrastructure projects designed to improve the environment along the U.S.-Mexico border. To date, 16 projects have been certified with a combined cost of nearly $230 million. Construction has already begun on seven projects, including a water treatment facility in Brawley, California and a water supply project in Mercedes, Texas. The NADBank will be able to leverage its capital into $2 to $3 billion in lending.

- The NAFTA Commission for Environmental Cooperation (CEC) has strengthened trilateral cooperation on a broad range of environmental issues, including illegal trade in hazardous wastes, endangered wildlife, and the elimination of certain toxic chemicals and pesticides.

- Through the CEC, Mexico has agreed to join the United States and Canada in banning the pesticides DDT and chlordane, ensuring that these long-lived, toxic substances no longer cross our border.

- The United States and Mexico have launched a Border XXI program establishing five-year objectives for achieving a clean border environment and a blueprint for meeting these objectives. U.S. and Mexican officials are now working to abate emissions from vehicles at border crossings, tracking transboundary shipments of hazardous wastes, and operating a U.S.-Mexico Joint Response Team to minimize the risk of chemical accidents, to name just a few activities.

- Mexico has established a voluntary environmental auditing program, which has completed audits of 617 facilities to date. Of these, 404 have signed environmental compliance Action Plans representing more than $800 million in environmental investments in Mexico.

- Mexico reports a 72 percent reduction in serious environmental violations in the maquiladora industry since the NAFTA was signed, and a 43 percent increase in the number of maquiladora facilities in complete compliance.